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United States Bankruptcy Court  
San Jose, California

Attorneys for Lone Oak Fund

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF CALIFORNIA  
SAN JOSE DIVISION

In re	)	CASE NO. 09- <sup>51900</sup> <del>01500</del> -ASW
BENYAM MULUGETA and PAULA R. MULUGETA,	)	Chapter 11
	)	
Debtor and Debtor in Possession	)	<b>DECLARATION OF BRIAN K. RAPELA</b>
	)	
<u>LONE OAK FUND, LLC,</u>	)	DATE: April 27, 2010
	)	TIME: (To Be Set)
Movant,	)	Courtroom: 3020
v.	)	280 S. 1 <sup>st</sup> Street
	)	San Jose, CA 95113
BENYAM MULUGETA and PAULA R. MULUGETA	)	
	)	
Respondents.	)	
	)	

**TO: DEBTORS BENYAM MULUGETA and PAULA R. MULUGETA:**

COMES NOW, secured creditor Lone Oak Fund, LLC ("Lone Oak"), and hereby submits the Declaration of Brian K. Rapela in opposition to the Debtor's motion to extend time on Order for relief from the automatic stay and/or motion for authority to sell real property ( 2332 Harrison Street, Oakland, California (the "Harrsion Property")).

**DECLARATION OF BRIAN K. RAPELA**

I, Brian K. Rapela, declare:

1. I am over eighteen years old and am employed by Hulberg & Associates , Inc., ("Hulberg") as a Senior Appraiser. I have been employed by Hulberg since 2003. My curriculum vitae is attached hereto as Exhibit "A". I have completed all of the requirements for the Appraisal Institute's MAI designation.

2. My appraisal experience consists of appraising a wide variety of property types including office, industrial, retail, vacant land, self storage and a variety of hotel properties. I have appraised such special purpose properties such as wind farms, athletic clubs, assisted living facilities and convalescent hospitals. A schedule of most recent assisted living facility and hotel appraisals that I prepared is attached hereto as Exhibit "B".

3. Except as otherwise noted, I have personal knowledge of the facts set forth below and, if called as a witness, could and would competently testify thereto under oath

4. I make this declaration in support of Lone Oak's Opposition to the motion to extend time on Order for relief from the automatic stay and/or motion for authority to sell the Harrsion Property filed by Benyam Mulugetq and Paula R. Mulugeta (collectively the "Debtors").

5. Hulberg was retained by Lone Oak to review the written appraisal dated May 3, 2009, prepared by Patrick J. O'Malley, MAI and Nannette F. Quigley of Detailed Analsyis (the "O'Malley Appraisal"), and render an opinion regarding the conclusions reached in the O'Malley Appraisal. In the course of this assignment, I was required to determine the highest and best use for the Harrison Property and therefrom provide an estimate of the Harrison Property's market value.

6. A summary of my conclusions regarding the accuracy, credibility and conclusions reached in the O'Malley Appraisal are set forth hereinafter.

7. The O'Malley Appraisal states on page 1 that the purpose of the report is to "support" a value for acquisition purposes. The O'Malley Appraisal concludes that the highest and best use of the Harrison Property "as improved" is for the renovation of the subject into a 156-unit assisted living facility. The O'Malley Appraisal then utilizes three approaches to value

1 (sale, income and cost approaches) to obtain a "value as complete" for the Harrison Property and  
2 then makes deductions in order to arrive at an "as is" value. Major issues arise within the  
3 O'Malley Appraisal and with its analysis and conclusion as to the highest and best use of the  
4 Harrison Property and under each of these approaches.

5 a. The appraisal report is that of a "self-contained" report, however lacks the  
6 necessary descriptions in many areas. There is no market overview section, either pertaining to  
7 assisted living facilities or to commercial real estate in general. In April of 2009 (the valuation  
8 date) economic conditions had deteriorated significantly throughout the U.S. as well as the Bay  
9 Area. Commercial property values decreased significantly and lack of any available financing  
10 essentially halted the market in terms of sales. The combination of declining market rents, lack  
11 of financing, rising interest rates and investors increased yield expectations caused a significant  
12 erosion of commercial property values. The O'Malley Appraisal fails to mention anything  
13 regarding the local economy or its effects on property values. Further, there is no market overview  
14 for assisted living facilities, the use that the O'Malley Appraisal deems to be the highest and best  
15 use of the Harrison Property.

16 b. As mentioned, the O'Malley Appraisal concludes that the highest and best use  
17 of the Harrison Property, as improved, is for the renovation of the subject into a 156-unit assisted  
18 living facility. In such a configuration, each room will have no private kitchen or bathroom  
19 facilities. This is highly unusual for assisted living facilities and not indicative of the marketplace,  
20 as indicated by the comparables used by in O'Malley Appraisal. Therefore, there is significant  
21 functional obsolescence in this proposed use that the O'Malley Appraisal fails to adequately  
22 address. Further, there are significant legal issues and time delays in converting the Harrison  
23 Property, including, without limitation, the following:

24 1) According to the current zoning, residential care is an allowable use only  
25 with a conditional use permit. The owner has not applied for such a permit. Further, even if the  
26 use were granted, the zoning allows a maximum of only 50 units on the subject site, compared to  
27 the 156 units that the O'Malley Appraisal is based on; and,

28 2) There is no onsite parking for the subject. Residential care use requires

1 some amount of onsite parking. The O'Malley Appraisal mentions that there are 40 off-site  
2 parking stalls being leased from a third party but does not mention where specifically, or what the  
3 lease terms are. Nevertheless, such offsite leased parking from a private owner would not meet  
4 the city's onsite parking requirements.

5 c. As such, the O'Malley Appraisal's conclusion of highest and best use as  
6 an assisted living conversion fails at the legally permissible level. Furthermore, I believe that any  
7 such conversion would not be financially feasible from a cost versus added value standpoint. Thus,  
8 I believe that the highest and best use of the Harrison Property continues to be as a residential  
9 single room occupancy (SRO) hotel, subject to renovations to the 3rd, 4th and penthouse floors  
10 in order to get that space into rentable condition.

11 d. Sales Comparison Approach: The O'Malley Appraisal used four sales of  
12 assisted living facilities, all of which closed in 2008. Market conditions have declined  
13 significantly after the credit crisis of October 2008, yet no adjustments for market conditions were  
14 made to any of the sales. In fact, virtually no adjustments were made to any of the sales for  
15 differences in locational or physical differences. The most significant difference between the  
16 subject property and the comparables is the lack of any private bathrooms or kitchens in the  
17 subject, as well as the significantly smaller average unit size, yet no adjustments were made for  
18 these differences. As a result, I believe that the Sales Comparison Approach utilized in the  
19 O'Malley Appraisal significantly overstated the value of the Harrison Property.

20 e. Income Approach: The O'Malley Appraisal used four "comparable" assisted  
21 living facilities to determine the market rental rate for the Harrison Property's hypothetical assisted  
22 living units. One of these was a convalescent hospital, which is simply not comparable. The  
23 O'Malley Appraisal again fails to make adjustments for the subject' property's inferior  
24 configuration of common bathrooms and kitchens. The three assisted living "comparable" sales  
25 all had mostly private and a few semi-private rooms, but no adjustments to the Harrison Property  
26 are made for these differences are in the O'Malley Appraisal. As a result, the O'Malley  
27 Appraisal overestimates the hypothetical market rent for the units at the Harrison Property.  
28 Furthermore, the O'Malley Appraisal utilizes a 9.0% capitalization rate, which is too low for an

1 assisted living facility. Historical capitalization rates for assisted living facilities are among the  
2 highest of all commercial property types due to their management-intensive nature. Market  
3 analysis would suggest that a capitalization rate of 11-12% is appropriate to the Harrison Property  
4 as a hypothetical assisted living facility. Based on these factors, I believe that the Income  
5 Approach utilized in the O'Malley Appraisal significantly overstates the value of the Harrison  
6 Property.

7 f. Cost Approach: The O'Malley Appraisal uses four land "comparable" assisted  
8 living facilities in order to value the Harrison Property. Again, the O'Malley Appraisal fails to  
9 address the recent significant declines in land values as a result of deteriorating market conditions.  
10 The O'Malley Appraisal relies most heavily on two active listings, which is not a good method  
11 for estimating value because of the often unrealistic expectations of sellers in this market.  
12 Replacement costs were estimated using an inappropriate cost guide property type, which  
13 overstates the actual reproduction cost of the Harrison Property. A physical deterioration factor  
14 of 8% was used in the O'Malley Appraisal, which is low considering the building is 75 years old.  
15 Moreover, no deductions were made for functional or external obsolescence. In my opinion,  
16 there is significant functional obsolescence in the Harrison Property given the lack of private  
17 bathrooms or kitchens in the units and the significantly smaller average unit size (assuming the 156  
18 units used by the O'Malley Appraisal). Also, external obsolescence exists with the Harrison  
19 Property as it relates to the existing depressed market conditions. Again, no market overview of  
20 assisted living properties was presented in the O'Malley Appraisal. Considering these factors,  
21 I believe that the Cost Approach significantly overstates the value of the Harrison Property.

22 g. In summary, all three approaches used by O'Malley Appraisal provide  
23 hypothetical values for the Harrison Property that are too high. I believe that the conversion of the  
24 Harrison Property to assisted living units is not financially feasible given the current market  
25 conditions. Further, such a use does not represent a conforming proposed use given that the  
26 zoning allows only for 50 units and that onsite parking is required. In my opinion, the highest and  
27 best use of the Harrison Property continues to be as an SRO hotel, subject to renovation of the  
28 3rd, 4th and penthouse floors to bring them to rentable condition.

1           8.       Some of the particular statements within the O'Malley Appraisal that do not  
2 support the estimated value of the Harrison Property as improved include:

3               a.       Sales Comparison approach (pages 27-31). In general, the O'Malley  
4 Appraisal made no adjustments for market conditions or any other item of physical or locational  
5 differences to any of the "comparable" sales. There have been significant decreases in commercial  
6 property values since the end of 2008. Capitalization rates for leased investments have increased  
7 about 150 to 250 basis points depending upon property type.

8               b       Sales Comparison approach (Page 27). Sale 1 is a newer, modern facility  
9 located in proximity to the Harrison Property. This "comparable" property sold at a 3.1 gross  
10 revenue multiplier (GRM) and a 8.7% capitalization rate. The only adjustment made in the  
11 O'Malley Appraisal was that the Harrison Property would support a GRM of 3.0 and a  
12 capitalization rate of 9.0%, presumably only for the newer effective age of the comparable  
13 property. This is not a good comparable for the subject due to its modern design and newer  
14 effective age and the adjustments suggested are far to modest.

15              c.       Sales Comparison approach (Page 28). Sales 2 through 4 are three  
16 additional sales of older facilities. Again, no specific adjustments were made to these  
17 "comparable" sales. At minimum, adjustments for declining market conditions are warranted.  
18 Commercial values have declined significantly since late 2008, and investors yield expectations  
19 have increased significantly, which means significant declines in value. Further, financing for  
20 investment properties is virtually non-existent, especially for business-oriented properties such as  
21 hospitality and assisted living properties.

22              d.       Sales Comparison approach (pages 27-31). All of these "comparable" sales  
23 were financed with the exception of Comparable 3, however Comparable 3 was part of a  
24 5-building portfolio and there is no discussion of how this may have affected the purchase price.  
25 Again, lack of financing in today's market is one of the factors driving values down. The ratio  
26 of gross building area per room is a good indication of overall conformance to the market in a  
27 physical sense. The Harrison Property's assumed 156-room assisted living facility equates to 267  
28 square feet per gross building area. This compares to the comparables below:



1                   1) The "comparable" sales range from 331 to 749 square feet per room,  
2 however Sale 4 is calculated on the number of beds, not rooms, so this number may be higher if  
3 there are shared rooms. Nevertheless, the Harrison Property is significantly inferior to all of the  
4 comparable properties in this regard and the O'Malley Appraisal makes no adjustments whatsoever  
5 for this.

6                   2) The O'Malley Appraisal concludes a value of \$90,000 per unit from the  
7 sales comparison approach. The adjusted unit price of the Harrison Property - as improved -  
8 should be significantly lower than the range of comparable properties given the deteriorated  
9 market conditions as well as the inferior overall quality of the assumed 156-unit assisted living  
10 facility.

11               e.       Income approach (pages 32-37). Again, the O'Malley Appraisal has made  
12 no adjustments to the rent figures derived from the "comparable" properties. Four such assisted  
13 living facilities are presented as comparable, with a description of services as well as rental ranges.  
14 All of these "comparable" properties have either private or semi-private rooms, as compared to  
15 dormitory-style shared restrooms for the Harrison Property.

16                   1) Comparable 1 offers individual apartments with a private restroom and  
17 limited kitchen area, which are far superior to the Harrison Property's configuration. The stated  
18 rent range is \$2,500 to \$4,000 per month. Because of the Harrison Property's much smaller  
19 rooms, common restrooms, and lack of private kitchens, a realistic rental rate would be well below  
20 the low end of this comparable's range.

21                   2) Comparable 2 is a convalescent hospital, which is not a comparable to  
22 an assisted living facility. Convalescent hospitals provide a significantly higher degree of nursing  
23 care and are consequently more costly (higher rental) than assisted living. This is simply not a  
24 comparable property.

25                   3) Comparable 3 is an assisted living facility in San Leandro with private  
26 and semi-private apartments and rental rates starting at \$1,800 (semi-private) to \$2,300 (private).  
27 Again, because of the Harrison Property's inferior configuration, it is likely that a concluded  
28 rental rate for the Harrison Property would be well below the low end of this comparable's range.

1                   4) Comparable 4 represents a newer, modern Sunrise Assisted Living  
2 facility with superior amenities. The property is significantly superior to the Harrison Property  
3 and rental rates for the Harrison Property would therefore be significantly less. The description  
4 of this comparable on pages 35-36 sounds like it was copied directly from Sunrise's marketing  
5 material.

6                   5) Without making any specific adjustments, the O'Malley Appraisal  
7 concludes that the Harrison Property as improved would generate rent of \$2,500 per room per  
8 month. The table on page 36 again illustrates that the Harrison Property's average room size is  
9 less than half of the average size of the comparable properties. Moreover, the Harrison  
10 Property's lack of private restrooms or kitchens warrants a significant downward adjustment. For  
11 all of these reasons, it is my opinion that, were the Harrison Property built out as the O'Malley  
12 Appraisal proposes, the market rent would be significantly less than \$2,500 per unit, per month.

13               f.       Income approach (Page 37). The O'Malley Appraisal goes through a very  
14 short income analysis using the (overstated) concluded gross rent. The vacancy factor of 5% used  
15 by the O'Malley Appraisal is not derived from the market. Operating expenses were taken from  
16 the "comparable" properties, which are not very comparable, but are in line with typical expense  
17 ratios of assisted living facilities. Again, increasing capitalization rates in today's market is not  
18 discussed in the O'Malley Appraisal, and, taking that into consideration, the capitalization rate  
19 used in the O'Malley Appraisal is far too low. Because the O'Malley Appraisal uses high market  
20 rent and a capitalization rate that is too low, the Harrison Property has been significantly  
21 over-valued. It is also noteworthy that, the O'Malley Appraisal states on the first page of the  
22 transmittal letter that there is no business value in the appraisal, yet it is indeed valuing the  
23 Harrison Property subject to gross revenues from a business operation.

24               G.       Cost approach (pages 38-45). Four land sales were utilized for the cost  
25 approach by the O'Malley Appraisal. The most recent is Land Sale 1 which sold for \$53 per  
26 square foot. The O'Malley Appraisal notes that this "comparable" has a superior zoning yet  
27 makes an overall 100% upward adjustment to the comparable for the Harrison Property's superior  
28 location. This implies an over 100% adjustment for location. Any comparable requiring over



1 100% adjustment for a single attribute is simply comparable.

2 H. Cost approach (pages 38-45). The O' Malley Appraisal's discussion of any  
3 adjustments is limited and there are inconsistencies. For example, the O'Malley Appraisal makes  
4 a downward adjustment for Comparable 3 for its listing status, but not to Comparable 4. Sale 4  
5 sold in 2006 with entitlements for 24 residential condo units. The O'Malley Appraisal fails to  
6 make a downward adjustment for market conditions. Land values have decreased significantly  
7 since 2006. The O'Malley Appraisal placed the most weight on the two listings and concludes  
8 a unit value of \$175 per square foot for the Harrison Property. In this market, many sellers are  
9 unrealistic in terms of value and are reluctant to lower their asking prices to meet a buyer's  
10 expectations. Relying solely on listings for a land value may lead to over-valuing the site. I am  
11 personally aware of a land sale in San Leandro which closed in 2007 and was approved for 51  
12 senior apartment units, which sold at \$49 per square foot. This would be a much better  
13 comparable in my opinion. Overall, the O'Malley Appraisal has overstated the land value of the  
14 Harrison Property.

15 I. Cost approach (Page 41). The O'Malley Appraisal uses the Marshall &  
16 Swift cost guide based on a good Class C retirement community complex, which has a base  
17 construction cost of \$140 per square foot. The description of a "Retirement Community Complex"  
18 is one in which each unit has its own kitchen and bath. A better category to use would have been  
19 "Elderly Assisted Living," which has smaller apartments and less amenities, at a base cost of \$99  
20 per square foot. Thus, the replacement cost used by the O'Malley Appraisal is obviously  
21 overstated in this regard.

22 J. Cost approach (Page 43). The O'Malley Appraisal estimates an effective  
23 age of only 10 years after the renovation, which is underestimated for a 75-year old building. The  
24 appraiser concludes a physical deterioration of 8%, which is significantly under-estimated.

25 K. Cost approach (Page 43). The O'Malley Appraisal notes no functional  
26 obsolescence in the Harrison Property's improvements. There is in fact significant functional  
27 obsolescence with regard to the inferior room configuration, and lack of private restrooms or  
28 kitchens.

1 L. Cost approach (Page 44). The O'Malley Appraisal notes no external  
2 obsolescence, and that supply and demand are in balance. However, there is absolutely no market  
3 data provided to support this conclusion and the contrary conclusion is indicated by the current  
4 market conditions.

5 M. In summary, based on the overstated land value, overstated replacement  
6 cost, and understated depreciation of the Harrison Property, the O'Malley Appraisal significantly  
7 overvalues the Harrison Property under the cost approach.

8 N. Reconciliation and As Is Value. The O'Malley Appraisal concludes a final  
9 value of \$13,500,000, "subject to completion." At page 46, the O'Malley Appraisal makes  
10 adjustments to reflect the income loss and costs associated with bringing the property to stabilized  
11 occupancy. The O'Malley Appraisal assumed a six-month lease-up time without any market  
12 support. In this current depressed market, such absorption time may very well be longer. The  
13 O'Malley Appraisal then makes the deduction for estimated construction costs as well as profit,  
14 and concludes an "as-is" value of "as improved" Harrison Property is \$7,500,000. As  
15 demonstrated above, the O'Malley Appraisal has overstated the hypothetical value of the Harrison  
16 Property as improved under each of the sales, income and cost approaches. Moreover, the  
17 O'Malley Appraisal's conclusion of highest as best use is not supported.

18 9. On February 12, 2010, I conducted an inspection of the Harrison Property. Prior  
19 to and thereafter, I had personally gathered data from which Hulberg could evaluate the highest  
20 and uses for the Harrison Property as well as provide Lone Oak with an estimate of its market  
21 value.

22 10. Based upon my review, analysis and inspection, I prepared and signed the written  
23 appraisal report for the Harrison Property attached hereto as Exhibit "C" on behalf of Hulberg.

24 I declare under penalty of perjury under the laws of the State of California that the  
25 foregoing is true and correct. Executed on April 12, 2010, at San Jose, California,

26   
27 BRIAN K. RAPELA  
28